DTS Annual Financial Audit Report

Action Item

Recommendation: Approve Independent Auditor's Reports for Fiscal Year Ended June 30, 2008.

Introduction

Government Code Section 11537 requires the Technology Services Board (TSB) to engage an independent firm of certified public accounts to conduct an annual financial audit of all accounts and transactions of the Department of Technology Services (DTS). An Invitation for Bid (IFB) was awarded to Macias Gini & O'Connell (MGO) to conduct a financial audit of the DTS for three fiscal years (FYs) ending June 30 (2006/07, 2007/08 and 2008/09).

MGO presented the results of its audit for the FY ended June 30, 2008, in the form of two draft reports: the *Independent Auditor's Reports and Financial Statements* (Appendix A) and the *Report to the Technology Services Board* (Appendix B).

Overview

In the *Independent Auditor's Reports and Financial Statements*, MGO issued an unqualified opinion which means that the financial statements are in conformity with Generally Accepted Accounting Principles. Furthermore, the results of compliance testing disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

Recommendations

The *Report to the Technology Services Board* contains the following new recommendation to management to improve internal control and operational effectiveness:

1. **Receiving Procedures and Segregation of Duties**

   Recommendation: A comprehensive procedures manual should be prepared that details the responsibilities of receiving personnel, with a focus on adequate segregation of duties.

   Response: DTS will prepare a procedures manual detailing the responsibilities of the various warehouse staff, with a focus on the appropriate segregation of duties. The manual will be completed by June 30, 2009.

Following are the FY 2007/08 Status of Recommendations from FYs ending June 30, 2006 and June 30, 2007:
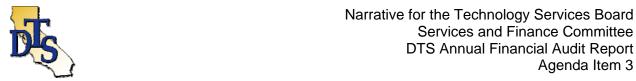
1. **Manual Journal Entries**

   Recommendation: Manual journal entries be prepared and posted by separate individuals to ensure adequate segregation of duties. MGO states that PeopleSoft application modules are designed to allow journal entries to be prepared and posted by separate individuals and DTS should use this feature of the system.

   Status: In efforts to implement the recommendation, it was determined that the version of PeopleSoft used by DTS does not contain the security feature allowing separate input and posting of journal entries. DTS has procedures requiring supervisor review and approval of manual journal entries. As a result, MGO now considers this matter resolved.

2. **Capital Assets**

   Recommendation: Source documents for capitalized amounts should include calculations supporting the amounts recorded in the accounting records. MGO also recommends that DTS remove capital assets from the accounting records only upon appropriate approval and that we maintain sufficient documentary evidence supporting the disposal.

   Status: DTS has improved its process for identifying capital assets. However, there are still some inconsistencies in the determination of capitalization due to the complexity of the invoices. DTS Accounting and Purchasing staff are working together to achieve a process that identifies all components of equipment so they are capitalized correctly.

3. **Employee Advances**

   Recommendation: DTS should actively monitor advances and follow its policies related to collections as outlined in the State Payroll Procedures manual.

   Status: DTS has updated and improved its procedures for collecting accounts from employees. Human Resources sends letters to employees notifying them of an outstanding balance and provides payment options. In cases where employees have retired or left the department, DTS is pursuing collection through offsets with the Franchise Tax Board. As of February 2, 2009, the balance of employee advances outstanding is $20,739, which is a reduction of $11,509 from the previous report. As a result, MGO now considers this matter resolved.

4. **Vacation Hours**

   Recommendation: DTS should monitor vacation balances and follow established policies to control future excessive accruals of vacation hours.

   Status: DTS continues to monitor employee vacation hours. On December 12, 2008, DTS issued letters to department Deputy Directors requesting that employees with over 640 hours of leave submit a plan for reducing their balances over the next two years. At the time the letters were sent, employees' accumulated excess leave balances had increased from 20,716 hours in FY 2006/07 to 23,812 hours in FY 2007/08. MGO considers this matter resolved.

5. **Inventory of Capital Assets**

   Recommendation: DTS should perform a physical inventory of capital assets and reconcile the inventory counts to the financial records.

   Status: Due to budgetary restraints, staffing shortages, and project interruptions, both the reconciliation and the policy and procedure portion of this task remain incomplete. DTS anticipates completion by August 2009.

6. **Aging of the "Due from Other Funds"**

   Recommendation: DTS should continue to communicate payment terms to customers since the balance due from customers as of June 30, 2006, was $71.3 million. Of this $71.3 million, $41.3 million or 58 percent was outstanding over 60 days and $28.9 million or 39 percent was outstanding over 90 days.

Status: Collection of payments continues to be slow. In January 2008, outstanding accounts receivable reached a record high of $90 million. At the December 8, 2008 TSB meeting, the Board approved mandatory direct transfer of customer payments. DTS will continue to provide monthly invoices to customers and will also notify the State Controller's Office to transfer the amount billed each customer to the DTS Revolving Fund. This process will assist DTS in collecting for services and reduce the Due from Other Funds balance. DTS plans to implement the mandatory direct transfer beginning July 1, 2009.

7. **Regular Change in Passwords**

Recommendation: DTS should use a standard password configuration in the network and financial application, and require changes in the passwords to provide system security.

Status: DTS continues to enforce passwords in accordance with department guidelines. DTS will enforce password expiration for the PeopleSoft application by the end of June 2009.

8. **Disaster Recovery Plan**

Recommendation: DTS should have a comprehensive business continuity and disaster recovery plan.

Status: DTS continues to work on the Disaster Recovery Plan. The implementation process was delayed when DTS decided to use different replication software than was originally planned. However, DTS anticipates the implementation will be completed by June 2009.

9. **Termination Policy and Computer Access**

Recommendation: DTS should develop formal procedures and perform an audit to ensure that no terminated employees or contractors retain computer access once they have left the department.

Status: DTS deletes employee and contractor system access when they leave the department. The DTS Security Division recently received a final report on the access control study which will be used to align DTS termination policy and computer access.

10. Policy for Periodic Reviews

Recommendation: DTS should develop a policy for periodic reviews of the financial application users to ensure their authorizations are up-to-date and proper segregation of duties are provided.

Status: DTS requires that PeopleSoft access and authorization rights and changes are approved by management. In addition, management reviews employee access each year to ensure adequate separation of duties.

11. Password Protection – Configuration Policy

Recommendation: DTS should require a minimum password configuration standard for network and application access.

Status: DTS policy requires a minimum password configuration for network and application access. The DTS Security Division will begin auditing the policy enforcement in 2009. DTS will implement the password requirement for the PeopleSoft application by June 2009.

12. Activity Matrix

Recommendation: DTS should periodically evaluate IT activities against defined metrics and report these findings to senior management.

Status: These enterprise performance measures were finalized on February 23, 2009.